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Near East and South Asia Review

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Special Issue: Privatization in the Middle East and South Asia

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28 March 1986

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Special Issue: Privatization in the Middle East and South Asia

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Near East and South Asia Articles

Privatization: What Is It, and Why Do They Do It?

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Privatization—the expansion of the privately owned portion of the economy—has become an important issue in the Middle East and South Asia over the past two years and will remain one for the near term.[1] Only some countries in the region have privatized, but the others have at least had to consider privatization as a policy option. Those countries that have privatized view this option as a way to stimulate industries that have stagnated under public ownership, increase the rate of economic growth, alleviate foreign exchange shortages, and remedy distorted international trade patterns. Countries that have privatized little or not at all subscribe to the beliefs that a government's political power rests upon its ability to control the economy, that economic well-being is best determined collectively, and/or that public-sector-dominated economies are too fragile to risk major restructuring.

Pragmatism is the driving force behind most privatization efforts in the Middle East and South Asia. There has been no widespread ideological conversion to capitalism. Instead, some countries have realized that the most reasonable alternatives to privatization will not work as well and that past policies are largely responsible for their present economic problems:

- In Saudi Arabia, government spending had been the engine for economic growth. Because of lower oil revenues, government spending has been cut, and the current five-year plan has placed increased reliance on the private sector to promote development and diversification of the economy.

[1] Privatization in the Middle East and South Asia is part of a worldwide development, appealing to people as diverse as British Prime Minister Margaret Thatcher and Chinese leader Deng Xiaoping.

- In India, growing budget deficits and stagnant industrial growth have led Prime Minister Rajiv Gandhi and his economic advisers to conclude that government alone cannot meet the goals set out in the Seventh Five-Year Plan.

- In Algeria, the failure of Soviet-inspired central planning to build an economy capable of outlasting the country's petroleum reserves is the main force behind privatization.

- Tunisia experimented with state socialism but found that it led to unsustainable financial losses. It then began to seek increased involvement by the private sector as the most feasible alternative.

Pressure from foreign lenders and donors is another incentive for privatization. Foreign funds are less readily available than they were in the recent past. Lenders and donors are beginning to insist that funds be allocated more efficiently to produce sustainable development.

Despite these practical considerations, several countries have been slow to privatize:

- Egypt has been particularly slow in privatizing and will remain so unless financial crises and pressure from donors force Cairo to change direction.

- Syria's economy is, and will remain, basically socialist, even though the poor state of the economy and a severe shortage of foreign exchange have forced the government to try to tap the wealth and expertise of the private sector.

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Privatization: How It's Done

Privatization is the expansion of the private sector, usually, but not always, the result of a transfer of assets from the public sector. Privatization can occur in any of the following ways:

- ***Divestiture*** *is the disposal by the government of all of its ownership and control of an enterprise. The most common form is sale of the enterprise to an individual or group of investors. Bangladesh has sold nationalized jute mills to the private sector, and Pakistan has sold rice and cotton-ginning mills. Sale, however, is not the only form of divestiture. Algeria has given state-owned land to private "homesteaders" who agree to use it to produce food.*

- ***Liquidation*** *is an extreme form of divestiture in which the government allows, or forces, an enterprise to go out of business. It does not directly expand the private sector. It usually occurs after an extended period of subsidization and after it is found that there is no way to make the enterprise profitable. India, for instance, may liquidate more than two dozen of its "sick" textile mills.*

- ***Partial divestiture*** *occurs when the government disposes, usually by sale, of some of its ownership in a company. By selling less than 50 percent of an enterprise, the government retains formal and, in some cases, actual control. Pakistan, for instance, has decided to sell some shares of Pakistan International Airways and the State Oil Corporation. Saudi Arabia has begun to privatize its $10 billion Saudi Arabian Basic Industries Corporation by selling shares to Saudi citizens and investors from the Arab Gulf states.*

- ***Management contracts*** *are most frequently used when the state wishes to retain ownership of an enterprise but finds that it needs specially skilled labor or managerial talent not available in the public sector. For instance, Saudi Arabia has a shortage of native health care professionals and contracts with private-sector firms—often foreign—to run clinics.*

- ***Cooperatives*** *are owned by the employees. In the Middle East and South Asia, the most common form is the agricultural cooperative.*

- ***Joint ventures*** *are partnerships between the government and a privately owned firm, domestic or foreign. India, for instance, is planning to construct two oil refineries and a petrochemical plant as joint public-private ventures.*

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A philosophical belief in the efficacy of free markets makes privatization more likely.

- Tunisian President Bourguiba apparently has come to share such a belief. His replacement, in the late 1960s, of a socialist economic czar with a team of technocrats favoring a free-market approach was a landmark in Tunisia's privatization efforts. Doubt about Bourguiba's successor and a slowdown in economic growth have contributed to a slowing in the pace of divestiture. Prime Minister Mzali, the most likely successor, appears to be as sympathetic to the private sector as Bourguiba.

- President Bendjedid of Algeria promoted several technocrats to key economic ministries in February 1986. This has been interpreted as an attempt to keep his economic reform program on course.

- Syrian President Assad's appointment in 1985 of a Western-educated economic reformist as Minister of Economy and Foreign Trade was both a tacit admission of economic problems and a modest overture toward the private sector.

- Prime Minister Rajiv Gandhi and many of his economic advisers favor increasing the role of the private sector in India as well as making the public sector more efficient. They have increased the pace of the reform program begun by Indira Gandhi.

In contrast, the dismissal of Mahbubul Haq as Finance Minister of Pakistan is clearly a bad omen for privatization in that country. Haq, a well-known and highly respected economist, was among the most vigorous advocates of privatization. His replacement is identified with a group opposed to Haq's reforms.

- *Removal of barriers to entry* allows the private sector to form companies in fields previously closed to it. In India, for example, the government recently invited the private sector to invest in the manufacture of telecommunications equipment and to bid for road construction contracts. Both areas had earlier been the exclusive province of the state.

For privatization to work, there must be not only a transfer to assets and/or control to the private sector but also creation or stimulation of an environment in which less regulated markets can function efficiently. Economic growth may suffer when private firms cannot survive or function efficiently because of restrictive regulations or unfair competition from state enterprises.

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ASPECTS OF PRIVATIZATION IN SELECTED COUNTRIES OF THE MIDDLE EAST AND SOUTH ASIA

Very High ● High ◓ Medium ○ Low ◒ Very Low ⊗

Not Applicable = NA
Not Available = na

	Prospects for More Privatization	Leader's Commitment to Privatization	Strength of Opposition to Privatization	Lender/Donor Interest	Quality/Quantity of Preparatory Studies	Access to Entrepreneurship	Capacity of Local Financial Markets	Acceptance of Foreign Investors	Reluctance to Take Over Money-losing Firms	Liquidation of Money-losing Firms	Privatization of Money-making Firms	Privatization of Firms in Key Sectors	Average Capital Used by Privatized Firms	Comments
Algeria	◓	◓	◓	na	◒	○	○	◒	na	na	na	⊗	⊗	
Bahrain	●	●	⊗	NA	◓	●	●	●	na	na	na	●[1]	○	A
Bangladesh	◓	◓	○	◓	na	◒	◒	◓	na	na	○	◓	○	B
Egypt	◒	◒	◓	◓	○	○	◒	○	NA	◒	○	◒	◒	B
India	◓	◓	○	◓	○	◓	◓	○	○	○	○	◒	○	
Iran	◓	○[2]	●	NA	NA	◓	○	⊗[3]	◒	○	◓	◒	◒	
Iraq	◓[4]	○	◓	NA	NA	◒	◒	◒[3]	○	◒	◒	⊗	◒	
Israel	○	○	○	●	○	◓	◒	◒	◒	◒	◒	◒	○	
Jordan	◓	○	○	○	○	○	◒	○	○	◒	◒	○	○	B
Kuwait	●	●	⊗	NA	◓	●	●	●	◒	◒	◓	◓[1]	◓	
Lebanon	◒[5]	◒	○	◒	⊗	●	◓	◓	◓	○	◒	◒	NA	A,B
Oman	○	○	⊗	NA	na	○	○	na	na	na	na	na	na	
Pakistan	○	○	◓	◓	na[6]	○	◒	◒	●	◒	◓	◒	◓	
Saudi Arabia	●	●	⊗	NA	◓	●	●	●	○	◓	●	●[1]	●	
Sri Lanka	○	○	○	◓	○	○	○	◓	◒	◒	◒	○	◒	B
Sudan	⊗	⊗	◓	◓	◒	◒	◒	○	NA	◒	NA	◒	◒	B
Syria	○	○	○	◒	⊗	○	◒	○[7]	◓	○	◒	⊗	NA	
Tunisia	○	◓	○	○	◓	◓	◒	◓[8]	○	◒	◒	⊗	◓	A
United Arab Emirates	●	●	⊗	NA	na	●	●	●	na	na	na	◓[1]	na	

Key to Comments

A. Has a strong private sector. References are to privatization of remainder.

B. Situation not conducive to investment because of insurgency, war, instability.

1. Except oil.
2. Sharp debate among leaders, policy inconsistent.
3. Rising rapidly.
4. Long-term better than short-term prospects.
5. Only traditional services in public sector.
6. Major commission study under way.
7. Arab investors accepted, not Westerners.
8. 49 percent maximum.

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Aspects of Privatization in the Middle East and South Asia

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A survey of the major economies of the region reveals a wide variation in policies toward privatization, the extent to which it has taken place, and the conditions that would encourage its further use.

Prospects for More Privatization

Countries of the region vary widely in their prospects for further privatization. Prospects for further privatization are best in countries that were relatively wealthy before privatization and that have a relatively bright economic outlook. All four countries with very high prospects for further privatization are wealthy Persian Gulf oil producers: Bahrain, Kuwait, Saudi Arabia, and the United Arab Emirates. Algeria, with the strongest economy in north Africa, has high prospects, as does India, which has experienced good economic growth recently. Such countries would have turned to the private sector even without their recent revenue problems. In each of these countries much of the infrastructure—roads, schools, and power networks—required for strong economic growth is already in place, often provided by the government. In addition, numerous countries, especially the hydrocarbon producers, are diversifying their economies, particularly into industries that do not require large amounts of capital. Algeria's recent five-year plan, which is probably typical of others, specifically mentions agriculture, tourism, retail trade, and the production of consumer goods as areas in which private-sector participation is to be encouraged.

Leader's Commitment

The leader's commitment to privatization seems to be the strongest determinant of the prospects for more privatization. Change in leadership often brings about change in the degree of commitment to privatization. Egyptian President Mubarak has encouraged private-sector activity less than did Sadat and Sadat more than Nasir. Although President Bendjedid has not privatized extensively in Algeria, he has done more than Boumediene. Prime Minister Rajiv Gandhi increased the pace of the reform program begun in India by Indira Gandhi. In contrast, there has been no leadership change in Syria, but the Syrians are beginning to try to tap the wealth and expertise of the private sector.

Strength of the Opposition

There is almost always some opposition to privatization, which may come from any combination of the following:

- Trade unions, such as those in India, whose leaders have attacked Gandhi's program as "antilabor" because it allegedly encourages plant closings and provides no relief for displaced workers. Unorganized labor may resist for the same reasons but will not be as effective.

- Industrialists who previously operated in sheltered markets and who now may have to face increased competition. Old-line industrialists in India may join labor in resisting Gandhi's changes.

- Bureaucrats who use public-sector firms as sources of patronage. They have, for example, been effective in slowing the pace of privatization in Pakistan.

- Consumers who receive subsidies through the artificially low prices that public-sector firms often charge for goods.

- Suppliers who are often paid artificially high prices for inputs.

The success of privatization may depend upon the relative intensity of the leader's commitment and the strength of the opposition. In every case in which the prospects for further privatization are very high, the leader's commitment is very high and the strength of the opposition is very low. In every case in which the prospects are low or very low, the strength of the opposition is higher than the strength of the leader's commitment.

Lender/Donor Interest
A published survey of the World Bank reports that the Bank has increased the emphasis it places on the private sector. The International Finance Corporation, an arm of the Bank, was created to specialize in financing private-sector businesses in developing countries and had its funding doubled in late 1984. In late 1985 the Bank was also organizing the Multilateral Investment Guarantee Agency to insure private-sector projects in less developed countries against noncommercial risks such as expropriation, breach of contract by host governments, and civil unrest.

We believe that lenders and donors do not exert substantial influence in bringing about privatization in the countries of the Middle East and South Asia. Those countries in the region that are most likely to privatize are not borrowers nor recipients of aid. Further, it is not clear that most lenders or donors would withhold funds over the issue of privatization.

Quality and Quantity of Preparatory Studies
According to published sources, privatization is most likely to succeed when it is based on extensive preparatory studies. Less developed countries, in general, and some Middle Eastern countries in particular, present problems that do not arise in more developed countries. Evaluating the worth of an enterprise is often difficult, especially in countries that do not observe standard accounting practices. Pakistan, for instance, attempts to measure the "social profitability" of many enterprises and tries to factor various measures of social welfare into computations also involving economic profitability. Because the privatized firm will not have the same objectives as it did when it was a public firm, the existing valuation is of only limited use.

Cost-benefit studies are often needed to indicate which firms to privatize. According to an official of the World Bank, there may be no net benefit to society if a public monopoly is sold to the private sector only to become a private monopoly. Moreover, because privatization almost always incurs opposition and will often be costly, studies will usually be necessary to ascertain whether the gain from increased efficiency exceeds the loss sustained by those who are made worse off plus the cost of the privatization.

The quality and quantity of the studies being done in the Middle East and South Asia appear to be at best mediocre. Only in Egypt, Sudan, and Tunisia are the quantity and quality of these studies higher than the general prospects for further privatization. Neither Egypt nor Sudan, however, seems likely to take action based upon those studies for the near term.

Access to Entrepreneurship
For a region with so many developing countries, the Middle East and South Asia has an uncommonly high degree of access to entrepreneurship, according to a US official who works on privatization in this and other regions. In several countries there is an established merchant or trading class with a long tradition. Where no such tradition exists, or where there are few experienced entrepreneurs, there is often an acceptance of the use of foreigners to serve as managers and entrepreneurs. This is frequently seen when privatization involves the creation of a new enterprise rather than the transfer of an enterprise, with its management, from the public to the private sector. For example, several Persian Gulf oil producers, which do not have enough entrepreneurs to manage all the firms that they wish to create as they diversify their economies, are relying on such devices as management contracts to enlist foreign entrepreneurs. Where decolonization was relatively peaceful, as in Tunisia, there was often access to Western enterpreneurial talent.

Capacity of Local Financial Market
Less developed countries, by their nature, rarely have well-developed, high-volume financial markets. This is true of most Middle Eastern and South Asian countries, with most of the exceptions being Persian Gulf oil producers. Lack of adequate financial markets tends to limit privatization, with most of it taking place in the smaller "cottage" industries. Without adequate financial markets it is difficult to

form groups of investors with sufficient funds to purchase or form large corporations. For instance, the fact that Pakistan's largest stock exchange has never raised more than $24 million in a year is a factor that will probably limit privatization efforts there.

Acceptance of Foreign Investors

If local financial markets cannot provide adequate funding, funds may be obtained from foreign investors. Nevertheless, we do not expect willingness to accept foreign investment to alleviate the problem significantly because of the hesitancy of foreigners to invest in many countries in the region. The countries most willing to accept foreign investment include Bangladesh, Egypt, Jordan, Sri Lanka, Sudan, and Syria—none of which is especially appealing to investors. Special restrictions, such as Syria's refusal to accept Western investors and Tunisia's limits on foreign participation, may further discourage investors.

Reluctance To Take Over Money-Losing Firms

Governmental reluctance to continue taking over money-losing enterprises is often the first sign that policy may be changing in favor of privatization. The announcement by the Pakistani Government that money-losers would no longer be nationalized was an early indication of such a change. The public sector often has grown as governments absorb money-losing firms to avoid letting them go out of business. Often there is pressure from labor to protect jobs or a perceived economic or national security reason to keep the enterprise open.

Liquidation of Money-Losing Firms

Liquidation of money-losing firms involves tougher decisions and a more active policy in favor of privatization and thus would be an even stronger indication of commitment to privatization than is the reluctance to absorb such firms. There appears to be little enthusiasm for liquidation anywhere in the region.

Privatization of Money-Making Firms

The sale of an enterprise that makes a profit for the government would be a particularly strong indicator that decisionmakers believe the business belongs in the private sector. Of the three countries—Kuwait, Iran, and Pakistan—with a high willingness to sell money-makers, the Kuwaiti leader's commitment to privatization is very high; in Iran there is one faction with a high commitment; and, until the recent change in government, the leaders in Pakistan had a very high commitment to privatization.

Privatization of Firms in Key Sectors

Throughout the region there is strong unwillingness to extend privatization to those sectors that produce large percentages of the GNP or that are deemed strategic. Even Saudi Arabia and Bahrain—which seem otherwise very willing to privatize—will not privatize the oil sector.

Average Amount of Capital Used by Firms That Are Privatized

Privatized firms in the region tend to have relatively little capital. Saudi Arabia is the only country with a very high average amount of capital in privatized firms. That is probably because of a combination of Saudi wealth and the success the Saudis have had in requiring firms from industrialized countries to invest portions of large contracts in Saudi firms. There are several reasons the average amount of capital used by privatized firms is low in the rest of the region:

- The diversification efforts of several countries involve a move away from highly capitalized industries such as oil and/or hydrocarbons to lower capitalized activities.

- Capital markets often cannot provide funding for projects requiring large amounts of capital, and foreigners are unwilling to invest in several of the countries of the region.

- Where the government is not enthusiastic—or is hostile—to the private sector, remaining small may be wise. In Syria, for instance, private firms are safe, provided they do not grow large enough to attract the government's attention.

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Saudi Arabia: Promoting Privatization [redacted] 25X1

Saudi Arabia is seeking increased participation of the private sector in the country's development. The focus on privatization has been stimulated by the decline in government revenues and Riyadh's hope that a more active private sector will offset the impact of reduced public spending. Although the government faces many challenges in implementing its privatization strategy, the Saudi private-sector response has been positive. In addition, foreign firms recognize the opportunities that exist for lucrative joint ventures despite the current recession. Saudi Arabia is a politically stable country with few exchange or capital restrictions and generous investment incentives. US firms are likely to benefit from the privatization effort because Riyadh is seeking projects that promote technology transfer and management training, areas in which US firms often have a competitive advantage. [redacted]

Economic Readjustment

Saudi Government spending has served as the engine for economic growth in the kingdom since the oil boom days of the early 1970s. Using oil revenues, Riyadh has generated employment, consumer demand, capital formation, and industrial, agricultural, banking, and commercial activity. It has also built a modern infrastructure—now essentially complete—carried out under contract by foreign and domestic firms. In addition, it subsidizes a wide range of goods and services for Saudis and underwrites the operations of specialized credit institutions that supply most of the private sector's long-term capital needs. Although the private sector has been active, particularly in trade and construction, its role has been overshadowed by the public sector. [redacted]

The decline in oil revenues beginning in 1982 forced Riyadh to trim its budget expenditures, a move that caused a ripple effect throughout the economy. The construction sector was hit hard when large government-funded projects were postponed or canceled. Riyadh cut the budgets of most government ministries and reduced some allowances and benefits to public-sector employees. It also stretched out payments to contractors, began to monitor contracts more closely, and started competitive tendering for government contracts. [redacted] 25X1

Because of budgetary constraints Riyadh is hoping that the private sector will assume a greater role in economic growth and development, according to Saudi press reports. In any case, as capital-intensive infrastructure and industrial projects were completed, Riyadh had planned to increase the private-sector role, and this sector has been expanding since 1980 because of government incentives. The recession, however, prompted Riyadh to try to use the private sector to counteract the contractionary effects of reduced government spending. [redacted] 25X1

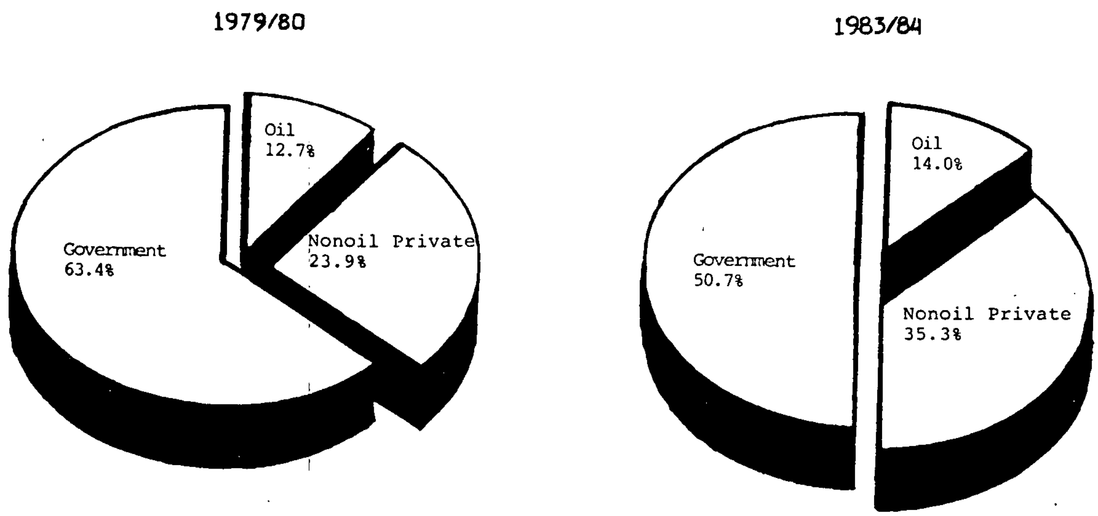
The Fourth Five-Year Plan 25X1

Saudi Arabia's $277 billion Fourth Five-Year Plan (1985-90), released last spring, focuses on privatization and diversification as the means to stimulate economic growth. According to the plan, the government hopes to limit its role to regulatory and promotional functions and to allow the private sector to meet the kingdom's demands for goods, services, and facilities. The key objectives in the plan involving the private sector are:

- To increase opportunities for the private sector to acquire, manage, and operate projects currently operated by the government.
- To encourage greater participation of the private sector in the financing of development.
- To encourage and facilitate private-sector investment in new products and to encourage banks to provide increased credit facilities for productive 25X1 projects instead of concentrating on trade financing.
- To encourage the establishment of joint stock companies. [redacted] 25X1

Government planners expect nonoil GDP to grow 3 percent a year over the course of the Fourth Five-Year Plan, slightly slower than the 5 percent a year

STRUCTURE OF GROSS FIXED CAPITAL FORMATION IN SAUDI ARABIA



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during the previous plan, and they hope the private sector will play a major role. Government expenditures will continue to be a significant force in the economy, but government output is set to fall to less than 9 percent of GDP, down from the current level of about 11 percent. In addition, Saudi planners assume that investment in the nonoil private sector will grow by 10 percent a year, increasing its share of gross fixed capital formation from the current 35 percent to 50 percent in 1990. Emphasis will be placed on development of manufacturing and petrochemicals, which together are slated to grow by 15 percent a year. In addition, Riyadh hopes to reduce the kingdom's dependence on imports from the current equivalent of 70 percent of nonoil GDP to under 50 percent by encouraging private-sector import substitution.

Riyadh hopes to guide the economy through these changes by providing public support for the private sector, according to the US Embassy in Riyadh. The government is committed to reserving an increasing share of government projects for the Saudi private sector. It has instituted a "30-percent rule," which requires that at least 30 percent of the value of a contract awarded to a foreign firm be provided by a Saudi firm, and is splitting large contracts into smaller ones better suited for Saudi firms. To encourage investment, Riyadh will offer low-interest loans and is considering changing other financial restrictions to make the kingdom more attractive to

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private Saudi investors. It intends to increase the use of joint ventures with foreign firms to capitalize on technical and business expertise. [redacted] 25X1

Privatization Begins

The private-sector response to Riyadh's privatization strategy has been positive. The government has been selling shares in the state-owned Saudi Basic Industries Corporation (SABIC) since 1984. Its aim is to offer 20 percent of SABIC's $10 billion stock for public subscription every two years until 75 percent is in the hands of Saudis and investors from the Arab Gulf states, according to Western press. The initial sale was heavily oversubscribed. [redacted] 25X1

The success of the initial SABIC divestiture has led Riyadh to consider selling other government firms. Last October, Riyadh proposed the privatization of Petromin, the Saudi state oil company [redacted] Under the proposal, Petromin will remain a state-controlled organization and operate as a holding company. Up to half of the shares in its various subsidiaries, including domestic and export refineries, would be sold to the public [redacted] The regime hopes that such sales will attract some of the estimated $20 billion believed to be in the possession of Saudi citizens. Riyadh would promise to continue subsidizing these organizations to convince investors that they will provide a good return, [redacted] 25X1 25X1 25X1 25X1

The government is also encouraging investment in new small- and medium-size manufacturing and services. Last spring it established the National Industrialization Company (NIC), a joint government-private enterprise that would establish industrial projects with Saudi capital and in conjunction with foreign partners. Within a few months of its launching, however, Riyadh announced that the NIC would be a wholly private venture. This announcement dampened investor interest in the NIC. Most were reluctant to invest in industrial ventures with no government participation. The NIC still hopes to raise $170 million from banks and industrial groups, with 75 percent held by the Saudi public. NIC's target is to set up about 10 new concerns each year, sharing 50 to 60 percent of the equity with foreign partners, according to Western press. Another venture capital group was formed last December. It includes 30 leading Saudi businessmen who will conduct feasibility studies and allow its underwriters the first option to invest in those projects that go forward, according to the US Embassy in Riyadh. [redacted] 25X1

Riyadh supports joint ventures with foreign firms and developed the Peace Shield offset program to use the kingdom's high level of defense spending to promote economic diversification, technology transfer, private-sector growth, and job training. The program stipulates that foreign contractors who participate in Peace Shield—$5 billion worth of projects to improve Saudi air defenses and communications—must place 35 percent of the value of goods and services they provide in high-technology ventures in the kingdom. Boeing, which won the first $1.1 billion Peace Shield contract, has proposed nine offset projects, including the establishment of factories for the production of telecommunications, avionic equipment, and medical supplies. General Electric, another contractor, has proposed the construction of an aircraft engine overhaul and repair facility. Moreover, foreign firms involved in offset projects are offered a wide range of investment incentives, including concessionary financing; a 10-year corporate tax holiday; government funding to cover the training of Saudi employees; provision of low-cost land, utilities, and feedstock; and duty-free imports of equipment and raw materials. [redacted] 25X1

Riyadh also is seeking ways to develop its banking system and capital markets to facilitate private investment. Early last year the government moved to expand the stock market, which until then had 35 brokers trading in 40 stocks. Commercial banks, rather than brokers, began selling stocks. The new system remains heavily regulated by the Saudi Arabian Monetary Agency—to prevent something similar to the stock market crash in Kuwait—and trading is thin. Only one stock issue can be floated at a time, and the Ministry of Commerce fixes its sale price; bank commissions on stock trades are small. Buyers must pay in cash when they place their orders. Except for citizens of the Arab Gulf states, no foreigners are allowed to buy shares in Saudi companies.

Riyadh has taken other initiatives to increase the private-sector role in development finance. It is encouraging commercial banks, which had concentrated lending on trade finance, office construction, and providing working capital for manufacturers, to broaden their services and thus help sustain private-sector growth. To support these banks, the government has imposed restrictions on offshore banks—primarily Bahraini—that had attracted large amounts of Saudi business by exploiting the competitive advantages accruing to it as an offshore banking center. The Saudi Arabian Monetary Agency also created Bankers Security Deposit Accounts, designed to reduce excess domestic liquidity. These instruments function like US Treasury bills and are offered to domestic banks on a discounted basis.

Riyadh believes that to facilitate privatization, the private sector will have to become more competitive by restructuring and focusing greater attention on management, organization, marketing, and accounting methods, according to the Saudi press. Saudi firms, for example, lack generally accepted accounting principles under which to operate, and that makes it difficult for investors to evaluate companies. The government intends to facilitate private-sector restructuring and has begun to insist on greater financial discipline from companies requiring loans. It also is planning national and regional trade exhibitions, as well as conferences on management and marketing.

Outlook

Saudi Arabia's privatization efforts will continue to strengthen the economy. Although the effects of the lingering recession will persist, government efforts to foster the private sector should reduce the economy's vulnerability to oil market fluctuations. We do not expect a rapid transition as Riyadh seeks to establish a partnership between the private and public sectors without causing disruptions. The business community appears eager to take a larger role and expects real growth over the next five years despite the recession and the poor outlook for the oil market, according to press reports. 25X1

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The government, however, will retain its dominant role in the economy. It will work to attract private capital to specific enterprises and seek greater public participation in the development process, but it will not turn over control of key areas—particularly oil—to the private sector. The private sector probably will not push for a significantly larger role in the economy until economic conditions improve, because investors are careful not to risk participating in enterprises without government backing. 25X1

Riyadh's privatization strategy so far has been well received by the Saudi public, but the government faces several challenges as it continues to implement its program. Although Riyadh wants to protect its infant industries, it is reluctant to erect new trade barriers because it wants to avoid foreign retaliation, especially against its petrochemical exports. Thus, many of the import substitution enterprises it hopes the private sector will develop may not prove viable. 25X1

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The Saudis have yet to develop commercial laws to deal with the complexities of a modern financial system. Without this legal framework, banks are left with little protection and are reluctant to play a larger role in the private sector. Developing such a framework is difficult because it involves a compromise between the religious community and the commercial sector. The stock market is relatively inactive, in part because of extensive government regulations. As Riyadh's need to stimulate investment grows, the benefits of a strong market may outweigh Saudi conservatism and bring about a cautious liberalization of regulations. 25X1

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Riyadh's emphasis on joint ventures with foreign firms will benefit US firms. In the past few years the number of joint-venture companies has increased significantly, and at present there are approximately 800 operating in the kingdom. The United States has the most—257 firms. US firms already have won many of the Peace Shield offset projects and probably will be able to bid successfully on other defense and high-technology projects. In addition, the focus on improving management will favor US advisory and consulting firms because they have a reputation for quality.

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India: Looking to the Private Sector for Help

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Prime Minister Rajiv Gandhi is trying to stimulate and modernize India's economy by opening it to more private-sector involvement. Growing government budget deficits and stagnant industrial growth have made it apparent to Gandhi and his advisers that the government alone cannot accomplish the goals for economic growth set forth in the new five-year plan. Opening more of the economy to the private sector will offer new opportunities to Western businessmen.

Gandhi clearly intends that the government control the direction of the economy. Although easing restrictions on private businesses, he has retained the basic structure of industrial licensing, preferences for small producers, and close supervision of large corporate groups. Gandhi apparently has no plans to rely completely on market forces to allocate basic consumer goods. He will continue the public distribution system that supplies grain to urban consumers and supports prices farmers receive for major crops.

The Public and Private Sectors
The Indian private sector produces about three-quarters of the national income. It is dominated by small-scale agriculture and a relatively limited modern industrial sector.

The central government is firmly entrenched as the prime mover and major source of direction for the economy, particularly the nonagricultural sector. The Indian Government—like other governments in less developed countries—inherited the major public utilities at independence and subsequently increased the industrial activities it owned or controlled—from five enterprises to more than 200, accounting for more than 70 percent of industrial production. Government control over all economic activity has become pervasive through subsidies and regulations. Expansion of the Indian public sector paralleled public growth in other formerly colonial economies. The government's current focus on the private sector also parallels that of other Middle Eastern and South Asian countries.

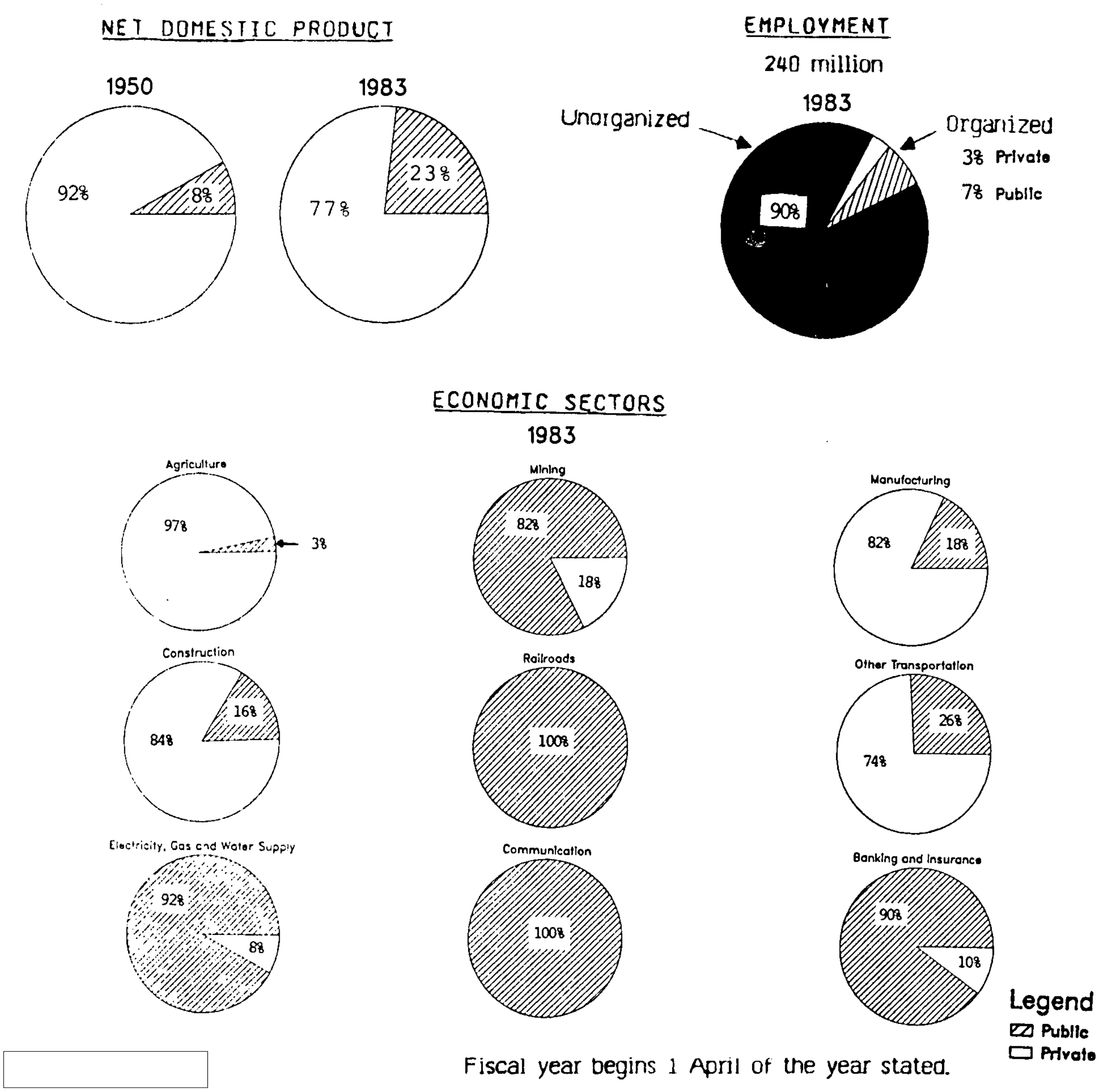
Government ownership ranges from heavy industries to consumer goods. The public-sector share of production is 97 percent for coal, 100 percent for crude oil and refining, 75 percent for basic steel, 55 percent for fertilizer, and 93 percent for power generation. The public sector also accounts for the production of most heavy engineering equipment, runs the railways and telecommunication services, owns more than 90 percent of the banking industry, and monopolizes the life insurance business.

Constraints to Economic Growth
Indian studies indicate much of the public sector has become stagnant and inefficient because of government control and lack of competition. Government statistics show that 200 public-sector companies together earned a mere 0.8 percent on capital invested in Indian fiscal year 1983. In contrast, the large- and medium-size private companies showed a return on capital of about 6 percent. The low rate of return in the public sector has led to an increasing gap between saving and investment in that sector.

The last five-year plan fell 18 percent short of planned expenditures primarily because state enterprises could not provide the necessary resources. Large government budget deficits caused by growing government salaries, subsidies on food and fertilizer, and defense spending and declining productivity resulting from increases in the amount of capital needed for public-sector production are making it difficult for the government to free additional funds for economic development.

Gandhi's Pragmatic Approach
The inability of public enterprises and the central government to generate the resources for development have contributed to Gandhi's push for more private-sector involvement. Finance Minister V. P. Singh has

THE PRIVATE AND PUBLIC SECTORS IN THE INDIAN ECONOMY



Fiscal year begins 1 April of the year stated.

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stated, "Our policy comes not from textbooks but from three points of hard reality—rupee resource constraints, foreign exchange constraints, and poverty." In the current five-year plan (FY 1984-89) the government is looking to the private sector to provide 52.2 percent of total investment of $273 billion compared to 47 percent under the preceding plan. About 10 percent of the private investment is projected to come from external sources.

Rajiv has publicly pressed for more private-sector initiative. He has emphasized that "many things could be done better" by private organizations, leaving the leaner government to concentrate on such things as development of infrastructure—roads, irrigation, and energy. Several of his ministers and many government economic advisers—some of whom have philosophies that are oriented to free markets—also are promoting the private sector. Government efforts include large issues of bonds to raise funds for public corporations, reduction of controls on existing business operations, and provision of incentives to expand production and exports:

- Indian Telephone Industries and the National Thermal Power Corporation placed large bond issues—more than $80 million each—on the market in February 1986; the Rural Electrification Corporation was to float a major bond issue in March; and the Indian Petrochemicals Corporation, Ltd. is preparing an issue for later release.

- Private companies are being invited to invest in telecommunications equipment—ending the monopoly of the public sector.

- Licenses are no longer needed to establish or expand capacity in 25 industries including machine tools, automobile parts, scientific instruments, and some electronic components, provided the manufacture does not occur in a major city.

- Manufacturers of motor vehicles, paper products, and some types of machinery and electronic goods may now vary their product mix within broad categories.

- Antimonopoly legislation, which imposes additional restrictions on production and investment, will now apply to only about 800 corporations compared with more than 3,000 in 1984.

- New import licensing regulations remove restrictions on some industrial machinery and offer a new duty-free import scheme for exporters.

- Maximum interest rates on bank loans to private enterprises have been reduced.

- Corporate and personal tax rates have been lowered, and a long-term fiscal policy calling for stability in corporate and personal tax rates during the life of the current plan has been proposed.

The government also has opened major projects to be funded independently by the private sector or as joint ventures, and in areas long barred to private-sector participation:

- The government proposes to invite private bids for road construction and to finance it through toll collections.
- Two new oil refineries and a petrochemical plant are being proposed as joint ventures.
- All six fertilizer plants scheduled to be built using offshore gas are to be allotted to private enterprises.

The government is moving cautiously away from supporting industries that are inefficient or losing money. The government hopes to avoid taking over "sick" industrial units to save jobs. It also proposes the liquidation or sale of government-owned units that chronically lose money and have no chance of becoming viable. At the top of the list is the closure or sale of 26 of the 100 or so "sick" textile mills. Other candidates include two bicycle manufacturing units.

Other measures under consideration include reducing the state equity in some profit-making enterprises and inviting experts from the private sector to serve as directors on the boards of major public-sector undertakings. The Steel Authority of India, the holding company for state-owned steel plants, has been losing heavily, while the country's oldest private steel plant, operated by the Tata family, has been running profitably. Press reports indicate Gandhi may also open production of defense materials to the private sector.

Private-Sector Response

Although we believe specific measures to ease government restrictions on private production and investment thus far have been moderate, the attitude of most businessmen has ranged from cautiously optimistic to euphoric:

- Finance Ministry approval of new private-sector issues of securities jumped by 40 percent in April through December 1985 from the comparable period in 1984.

- Applications for investment authority rose from 1,064 in 1984 to 1,271 in the first 11 months in 1985, and the number of industrial licenses issued rose from 905 to 925.

- The stock market index rose from 135 in December 1984 to 232 in December 1985 (1980-81 = 100).

- The value of new security issues sold on the capital markets in 1985 increased by 50 percent over 1984, and investors have begun to think in terms of larger issues than would have been possible only a year ago.

- Private industrial borrowing increased 9.2 percent in April through December 1985 over the same period in 1984.

More Privatization Likely

Greater involvement by the private sector—both domestic and foreign—appears to be India's most promising means of achieving significant economic growth over the next five years. We believe the private sector could undertake its portion of the development program and that private foreign capital would be available if the government continues to relax its control over the economy. As long as Rajiv Gandhi remains Prime Minister, we see steady, if slow movement toward more private-sector involvement.

Reliable economics press reports state that the World Bank is generally pleased with the results of past projects. We believe that future projects will be funded.

The pace of privatization is likely to be determined by the severity of the political obstacles encountered. There remain some people in the leadership, and more in the bureaucracy, who are accustomed to the system of state enterprises and government controls and are resisting change. Critics of Gandhi's program, including many in his ruling Congress Party, charge that his liberalization measures favor the rich and middle class at the expense of the poor. Price increases and the elimination of subsidies, necessary if the government is going to give more incentives to the private sector, are likely to create problems with the urban poor.

New Delhi's commitment to more privatization also will be tested if unemployment increases. Government liberalization of economic controls and regulations is likely to come under increased trade union pressure. A key union leader has already attacked the policy as "antilabor" because it encouraged plant closings and provided no relief for workers laid off. Urban unrest is also likely if unemployment rises rapidly.

Although the great majority of Indian businessmen welcome the promotion of the private sector and the removal of restrictions, there is a sense of concern, particularly among more established and old-line industrialists. The latter increasingly realize that open competition will mean the survival of only firms that are efficient and responsive to consumers. This is a concept alien to industrialists who have thrived in a largely protected sellers' market.

Implications for the United States

Greater Indian reliance on a market-oriented economy as well as a more open attitude toward foreign investment will increase opportunities for US businesses to enter one of the world's largest markets. Since 1980, US companies have been the leaders in gaining approval for financial and technical joint ventures with Indian entities. During the first six months of 1985, 92 collaborations were approved, and the number probably exceeded 200 for the year—a record high. Indian companies are eager to increase imports of high-technology equipment, particularly in the electronic, motor vehicle, and telecommunication industries, and the government is willing to allow foreign participation if foreign companies transfer technology, get involved in the production of export goods, or offer equity participation that saves Indian foreign exchange in capital-intensive projects such as refining and fertilizer plants.

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Algeria: Liberalizing the Economy [redacted]

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The failure of Soviet-inspired policies to build an economy capable of outlasting the country's petroleum reserves is the principal force driving Algeria toward a more market-oriented economic system. Under the direction of President Chadli Bendjedid, Algeria has begun dismantling state monopolies and incorporating private enterprise into its development programs. To date, the private-sector response has been less than hoped for because the bureaucracy has not created an environment conducive to private enterprise and would-be entrepreneurs are unsure of the role they are expected to play. Continued liberalization depends heavily on worldwide hydrocarbon developments. Greatly reduced oil and gas earnings could jeopardize Algeria's ability to provide necessary financial incentives to private investors. To the extent that a collapse of private investment can be cited by Bendjedid's opponents as the primary cause for Algeria's economic problems, he may feel compelled to reinstitute widespread state control of the economy. Bendjedid's continuing efforts to open Algeria to the West will create new opportunities for US trade and investment, and he will view the response of US firms as an important indicator of how close a relationship Washington wants. [redacted]

The Boumediene Economic System

The economic policies of President Houari Boumediene (1965-78) were aimed at using oil revenues and Soviet-inspired economic principles to make Algeria the "Japan of the Mediterranean." To realize his goal, Boumediene nationalized oil and gas companies in 1971 and implemented two Soviet-style development plans (1970-73 and 1974-77). Both plans were geared toward rapidly expanding the state's role in the economy. Over time, all key industrial sectors, foreign trade, banking, and insurance became state monopolies. Even agriculture fell largely under state control. [redacted]

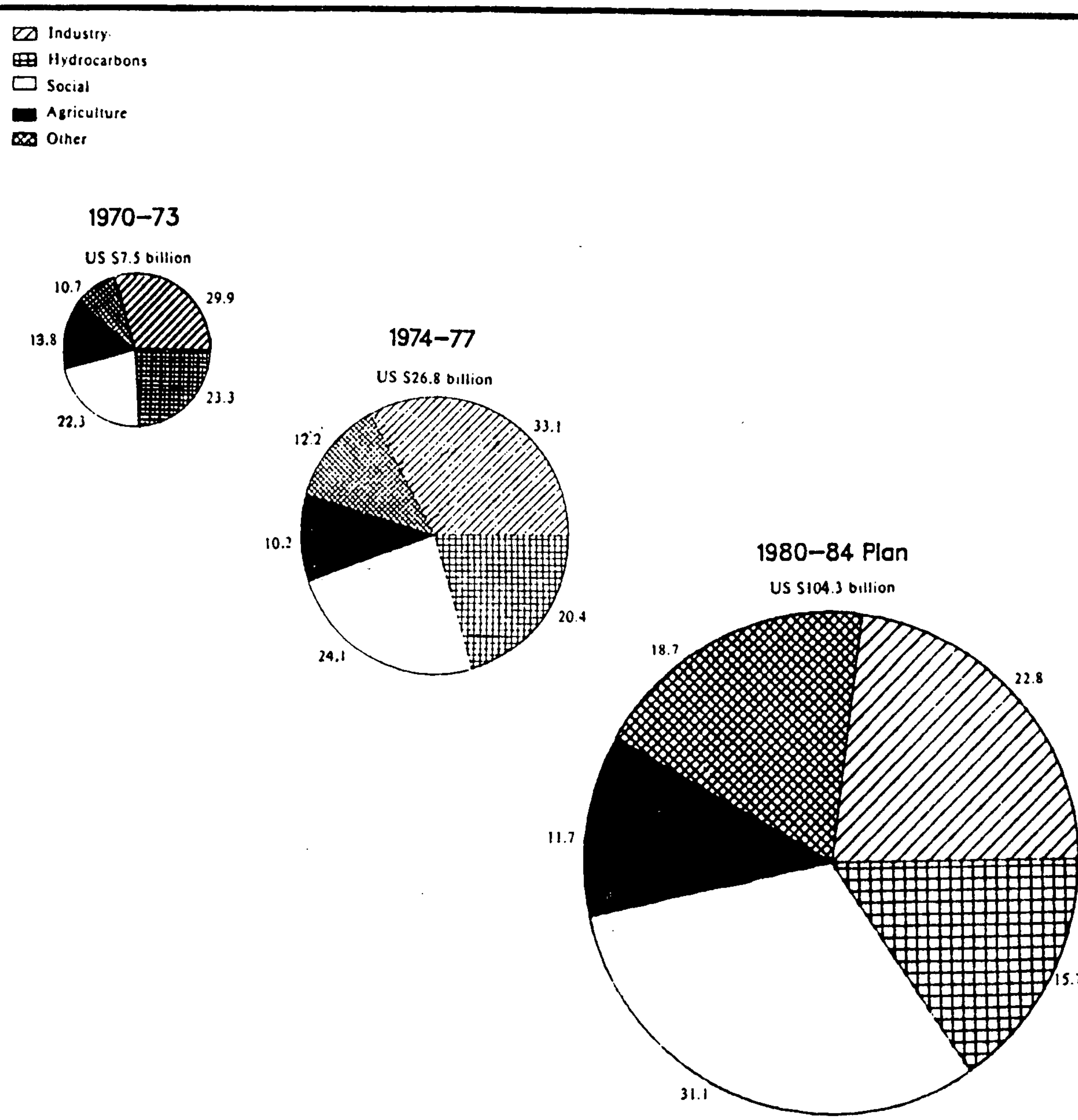
Oil-spurred economic growth—averaging 7 percent annually during 1974-78—masked serious problems in the economy. Agriculture was particularly hard hit. Highly centralized planning, inefficient marketing and input systems, inadequate production incentives, and a lack of skilled farm managers contributed to a more than 50-percent decline in production. The declining share of investment allocated to agriculture compounded these problems, especially the failure to exploit the nation's water resources.[1] [redacted] 25X1

Algeria's favored industrial sector also ran into trouble. Modern business techniques such as inventory control, production scheduling, and distribution were poorly managed. The level of technology insisted upon by planners was often beyond the capability of the local work force, fostering dependence on foreign technicians rather than upgrading the skills of Algerian workers. Soviet-style central planning also proved ineffective in matching production with demand. As a result, the country installed expensive industrial plants whose output did not match domestic needs. Guaranteed wages also hindered productivity gains and made production costs for locally made goods considerably higher than for imported products. As a result, the utilization rate of existing industrial capacity, [redacted] was only about 50 percent. [redacted] 25X1 25X1 25X1

Boumediene's industrialization drive also had harsh social implications. Serious strains on services developed as Algerians left the countryside and crowded into urban areas in search of jobs. Food shortages were commonplace, a result of declining agricultural production and accelerated rural migration to the cities. With heavy industry favored over other production, shortages of consumer goods were widespread. Domestic demand for such goods as automobiles, televisions, and refrigerators far exceeded supply—resulting in a thriving black market. Inflation during the late 1970s was as high as 18 percent on an annual basis. [redacted] 25X1

[1] Algeria, a net food exporter at independence, now imports about two-thirds of its food. [redacted] 25X1

FIGURE 1
ALGERIA: INVESTMENT SPENDING, BY AMOUNT AND SECTOR:
A SHIFT IN EMPHASIS



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Reorientation Under Bendjedid

Chadli Bendjedid's public statements indicate that he, unlike his predecessor, sees private investment as essential to building a highly diversified economy that will outlast the country's oil reserves. As a result, Algeria's economic development strategy has undergone a significant shift under his leadership. Bendjedid's initial $104 billion, five-year development plan (1980-84) called for striking changes focusing on decentralization of the state-controlled economy and an increased role for the private sector. Agriculture, tourism, retail trade, and the production of consumer goods were specifically mentioned as areas in which the private sector was to be encouraged to participate—a radical departure from previous plans, which completely ignored private enterprise.

A 4-percent annual increase in agricultural production was targeted under the plan. Agricultural reform emphasized the reorganization of the large nationalized sector comprising 2,000 farms into smaller, albeit still primarily state-controlled units. Managers were to be given greater autonomy and responsibility to increase productivity. The government also pledged to expand extension services to include independent farmers as well as the nationalized farms to encourage greater private participation. Nearly half of the $12 billion allocated to agriculture was to be for much-needed improvements in the use of water resources, to the benefit of both private and public farming.

Government plans for light industrial expansion included projects to increase the production of construction materials, textiles, and processed food. Tax reforms and improved access to credit, land, and equipment were to be instituted under the plan to encourage private participation. Heavy industry, including hydrocarbons, remained under state control.

Bendjedid's Report Card

Algeria's development efforts produced only mixed results during 1980-84, largely because of declining oil and gas revenues that limited spending—half of planned investment went unfunded—and to what government officials cite as a disappointing response from the private sector. We believe the limited private-sector response was in part because the appropriate environment had not been created. Moreover, would-be entrepreneurs, used to nearly two decades of extensive state control, probably were hesitant to do much without concrete guidance from the government. Supporting these judgments is a recent Algerian review of private-sector activities, which noted that private investment under the plan occurred without clear orientation or control from Algiers. 25X1

Private activity in agricultural production provides some interesting insights into why local investors hesitate to become involved. Although the data are sketchy, private-sector participation in agriculture was apparently limited largely by bureaucratic barriers. 25X1 Embassy sources indicate the Algerian bureaucracy was slow to turn to private entrepreneurs after years of dealing primarily with collective farms. The average private farmer, for example, was forced to accept government feed deliveries—with no control over timing or quality—because he was prohibited from importing his own needs. Furthermore, according to the Embassy, even if a farmer was resourceful enough to arrange a contract to supplement state supplies, the government routinely denied him the requisite foreign exchange. The average farmer also had trouble procuring drugs and veterinary services—government veterinarians received no additional pay for servicing private farms. State control over the marketing of domestically 25X1 produced farm products also limited individual farm production. Prices paid by the state were often far below cost and certainly below market prices. The government's inability to provide needed tractors and equipment to new farmers under its land redistribution program also limited output. 25X1

The gains recorded by private interests in light industry were far more encouraging than in 25X1 agriculture. According to Embassy reporting, about 1,200 private projects valued at some $800 million were approved by the government. Most of these undertakings were concentrated in large urban centers where access to goods, labor, and capital was most convenient. The projects were primarily in

El Oued: Economic Development in the Desert

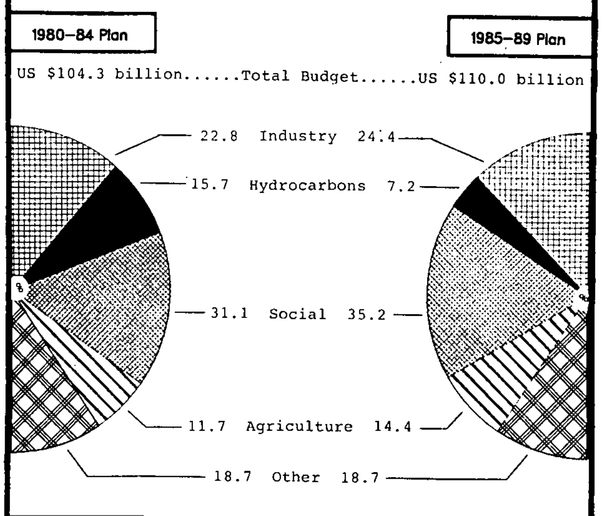
Local development in El Oued Province is a prime example of the positive effects of government emphasis on private-sector participation in the economy. El Oued is one of 17 new administrative districts in Algeria. According to the provincial governor, this change has brought increased state funds to the area and has led to rapid improvements in health, education, and housing. These upgraded living conditions, in turn, have improved the ability of the local population to focus their efforts more on production for profit rather than for survival, greatly encouraging private-sector initiative. [redacted] 25X1

El Oued leaders are further encouraging private participation—in line with regional goals set forth in the 1985-89 development plan—by prodding farmers to participate in a program designed to gradually shift local production from dates, their traditional crop, to food production. The governor has directed the building of five socialist agricultural villages—each with housing for 200 families, schools, mosques, and health clinics—to help accomplish this goal. In these villages, farmers will till their land and retain their profits but plant crops selected by district planners. According to the governor, this program is popular, and he expects El Oued to be self-sufficient in food in the next five to 10 years. [redacted]

Local officials have encouraged the establishment of privately owned light industrial projects in such diverse areas as food processing, cosmetics, and construction. Some firms, according to the governor, employ as many as 200 to 300 workers. Officials plan to encourage entrepreneurs to base new industrial ventures on local resources and needs—for example, a glass works using the area's fine sands. There are no plans to allow creation of privately owned heavy industrial projects, however, as decreed in the national development plan. [redacted]

"easy" activities that did not require too much risk or large investment of time or energy, and, above all, had the potential for quick profits. Embassy reporting indicates as many as 20,000 new jobs were created in such industries as building materials, textiles, and chemical products. [redacted] 25X1

FIGURE 2
ALGERIA: INVESTMENT SPENDING, BY SECTOR: THE SHIFT IN EMPHASIS INTENSIFIES



[redacted] 25X1

Looking Ahead

Although Algeria has the strongest economy in North Africa, we believe Bendjedid realizes he must continue his diversification and liberalization efforts to ensure Algeria's economic viability. [redacted] 25X1
[redacted] pragmatism, not ideology, is the standard by which the contributions of both the public and private sectors of the economy will be assessed. To encourage an even greater contribution from nongovernment sources, the role of the private sector has been more specifically defined in the recently implemented $110 billion 1985-89 development plan. Officials have been ordered to integrate private-sector activities into traditionally public-sector arenas to meet plan goals. Private industry is to "contribute to the expansion of Algeria's overall productive capacity, create jobs, mobilize savings, and spread development to distant regions and underprivileged zones." The fields of endeavor are likely to include: services, tourism, land transportation, and, in a notable departure from the previous plan, subcontracting in metal working, 25X11

25X1

mechanical engineering, electrical and electronic industries, and industrial maintenance and repair. Private enterprise, however, is still prohibited from a role in priority areas such as petroleum. [redacted]

Despite the plan, Algeria's continued economic good health and liberalization efforts depend heavily on developments in the world oil market. Hydrocarbon sales account for 98 percent of Algerian export earnings and about half of government revenues. Algeria loses $260 million annually in export receipts for each $1 decline in oil prices at current production levels of 700,000 barrels per day (b/d). Moreover, every 100,000-b/d drop in oil exports at current prices costs the regime almost $1 billion. Assuming Algeria can continue to produce 700,000 b/d during 1986 but prices stabilize at $15 per barrel, Algiers would lose as much as $3 billion in oil earnings. [redacted]

Because Algiers continues to insist on linking its gas prices to official OPEC crude oil prices rather than to market prices, $15 per barrel oil has significant implications for natural gas sales. Even if Algiers can continue to sell the same amount of gas as in 1985, the country could lose more than $1 billion in gas earnings. Moreover, it is becoming increasingly unlikely that Algeria will be able to maintain current exports. Algiers has begun renegotiating gas contracts with its European customers—Belgium, France, and Italy—but the process is expected to be difficult and protracted. With gas prices falling in Europe, Algeria will be under considerable pressure to agree to a lower price to retain these customers. As matters now stand, Algerian gas is as much as 40 percent more costly than alternative Dutch, Norwegian, and Soviet supplies. [redacted]

Continued low world oil prices or a sharp drop in the price or amount of natural gas sold to traditional European customers would force Algeria to radically reduce development efforts or resort to heavy borrowing on the international market. Both are unpleasant options. Reducing development efforts threatens Algeria's ability to prepare the way for an economy without oil—Algiers expects to become a net oil importer in the 1990s. Borrowing heavily abroad is also unappealing because, with oil and gas as primary collateral, bankers are likely to exact high interest rates and other concessions from Algiers on any loan.
[redacted] 25X1

In a time of reduced hydrocarbon earnings, political forces could also threaten private-sector expansion. Hardliners are likely to blame Bendjedid's economic reforms for any ill effects of reduced hydrocarbon earnings. Despite the President's considerable political influence, an oil-spurred economic recession could give his opponents the wherewithal to force him to step back from his efforts to liberalize the economy, jeopardizing fledgling private-sector development.
[redacted] 25X1

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Algeria's worries over the vagaries of the world oil market will cause it to remain keenly interested in furthering economic ties to Washington. The government has already expressed special interest in acquiring more US technology and expertise to help meet its agricultural and water resource plan goals, a large part of which is hoped will be private-sector led. Algiers also is interested in US sources of resupply for its Soviet-equipped armed forces, according to the US Embassy. If oil prices remain depressed, Algiers will probably press for concessional loans and will interpret Washington's support of US firms operating in Algeria as a sign of US interest in closer bilateral relations. [redacted] 25X1

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Economic ties are not likely to set the pace for developing political relations between Algiers and Washington. Despite Algeria's less doctrinaire attitude, the divergence in political viewpoints between the two capitals on Middle Eastern issues will limit progress. Algiers probably will want to move carefully in developing bilateral ties because of what it views to be Washington's continuing military and diplomatic support for Morocco, as well as Algeria's own interest in maintaining ties to radical Arab states. [redacted] 25X1 25X1

[redacted] 25X1

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Tunisia: Prospects for Privatization

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The private sector has provided substantial impetus to the development of Tunisia's economy. President Habib Bourguiba's favorable disposition toward private initiative has resulted in significant legislation and financial incentives that should continue to promote private-sector development. Nevertheless, bleak economic prospects and the political uncertainty generated by the impending presidential succession probably will slow movement toward divestiture of public enterprises and limit Tunisia's ability to attract foreign capital. In the restricted resource environment likely to prevail through the end of the decade, privatization efforts will have to be focused on streamlining operations of financial institutions and improving the efficiency of the agricultural sector. Moreover, the government will have to enact new legislation to correct imbalances in private development policy and to redress growing regional and demographic disparities.

The Roots of Private Initiative

Tunisia's experience under French protection from 1881 to 1956 had a profound influence on the direction of its economic development as an independent state. France left the country's natural and human resources almost wholly unintegrated and dependent on foreign management. Natural resources were exploited to serve the French economy. Most foreign residents were merchants or administrators who were not interested in training a cadre of Tunisian industrialists or entrepreneurs. At independence only 50,000 Tunisians were employed in domestic manufacturing. Moreover, education and training of the population were not priorities during the protectorate; 75 percent of Tunisians were illiterate in 1956. Unlike neighboring Algeria, the French withdrawal proceeded relatively peacefully over several years, allowing continued access to the French economy and an opportunity for Tunisian President Habib Bourguiba to implement moderate economic and educational reforms.

The state served as Tunisia's principal economic engine from independence through the late 1960s. Beginning in 1962, then economic czar Ahmed Ben Salah attempted to redress the lack of private capital and entrepreneurial talent by collectivizing Tunisian agriculture and industry. By 1969 the financial losses of the cooperative experiment became unsustainable, and Tunisia's state socialist experiment ended, despite its significant development of basic infrastructure and industry. President Bourguiba replaced Ben Salah with a new team of politicians sympathetic to Western economic policies and a free-market approach to development. 25X1

Since 1970 the government has encouraged existing private economic activity and the establishment of new private enterprise. Significant enactments in 1972, 1976, 1978, 1981, and 1984 opened the way for financial incentives for foreign investment in export-oriented sectors and the agricultural sector. 25X1 Liberalized trade policies also have helped stimulate greater private participation in the economy. The work force is one of the best educated in Africa. 25X1

The stability of political leadership under Habib Bourguiba and his favorable disposition toward private enterprise and the West have reduced economic uncertainty and given continuity to the country's economic development. The selection in 1980 of Mohamed Mzali—a liberal on economic policy—as Prime Minister and heir apparent to Bourguiba underscores the regime's commitment to private development. 25X1

Public Versus Private Development

Since independence, the public sector has been an important part of Tunisia's economy. The government continues to control some 550 enterprises that are considered either strategic concerns (public utilities

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and banking), too costly for private ownership (steel, hydrocarbon, and phosphate production), crucial for national development (tourism in the 1970s), or essential to maintaining regular supplies (cereal distribution). These enterprises produce 25 percent of the country's GDP, employ 35 percent of the population, and pay 38 percent of wages. They account for 75 percent of exports and 45 percent of imports and absorb 40 percent of total investment. Nevertheless, the public sector in Tunisia has long been characterized by inefficiency, poor productivity, and corruption.

The government's promotion of private enterprise has paid handsome dividends. Private economic activity was the engine behind rapid economic growth during the 1970s, averaging 7.3 percent during the decade compared with 6.7 percent in neighboring Algeria. Cereal production almost tripled during this period as farmland was returned to private ownership. Moreover, between 1973 and 1980 almost 600 foreign firms established factories under Tunisia's revised investment laws, creating 90,000 positions in light manufacturing and supplying $1.6 billion in private investment. Tunisia's private sector—including agriculture—employs 50 percent of the population and accounts for 75 percent of GDP.

The growing financial burden of public enterprises on state resources—$425 million in subventions last year—is pushing Tunis to reform the sector. Legislation enacted last year specifies that firms with state ownership exceeding 34 percent will remain in the public domain and eligible for public subsidies. The government will reexamine all public firms by the end of this year and will increase its equity share to 34 percent in those firms that will remain in the public sector. Other firms will be sold or liquidated and the proceeds used to improve efficiency in the remaining state enterprises. This measure could cut to 300 the number of public-sector firms.

A major intent of the new law is to shift state investment away from nonstrategic concerns. Tunis defines nonstrategic sectors as those in which resources are adequate or expanding, in which private competition is healthy, and which are well developed—tourism and agricultural equipment distribution, for example. Strategic sectors targeted for continued state control are either those that provide essential public services or, in the case of hydrocarbons, are a major source of foreign exchange. 25X1

In practice, the reforms will do little to develop private enterprise. The US Embassy in Tunis says the reforms are an effort to get development banks from the Gulf states and other private investors to assume the role of the state in financing selected public enterprises. The new owners will not be allowed to 25X1
determine levels of employment and must agree to maintain existing management policies as a condition of ownership. Since the intent is to shift sources of funding rather than policies, little change can be expected in the efficiency or profitability of the new "private" concerns. 25X1

Obstacles to Privatization

Tunisia's efforts to enhance private participation in the economy have created at least three major problems. The structure of industrialization under the private capital investment laws has been unbalanced, and no mechanism has been established to correct the overconcentration of capital in some sectors such as the textile industry. Moreover, privatization policies 25X1
have tended to skew Tunisia's industrialization policy toward an overdependence on a narrow spectrum of exports targeted at the European market. Finally, legislation has adversely affected the location of new production facilities, increasing the concentration of industry and population in coastal areas to the detriment of the interior. 25X1

Tunisia's bleak economic prospects will hinder progress on correcting these economic imbalances. Textile and agricultural exports—34 percent of foreign exchange receipts—are facing stiffer quotas in Europe. Demand for Tunisian phosphates—20 percent of exports—also is weak. Tourism has ceased 25X1
to be a source of growth because the industry is reaching maturity, and worker remittances are down because of the expulsion of Tunisian expatriates from Libya. 25X1

More ominous is the slide in world oil prices. The US Embassy in Tunis estimates that $20 per barrel oil will increase this year's budget deficit by 10 percent, trim 2 percentage points off GDP growth, and increase the current account deficit by $70 million. A $15 per barrel average price would almost double the impact. Available domestic resources almost certainly will have to be used to finance urgent social programs instead of private-sector development. An already troubling debt service burden—a projected 25 percent of goods and services exports this year—probably will preclude substantial foreign borrowing. [redacted]

Tunisia's powerful labor movement also is an impediment to further privatization. For example, union leadership already has stated its opposition to plans to return the national transportation company to the private sector by the end of 1986. The US Embassy in Tunis says the six union-affiliated deputies in the National Assembly voted against public-sector reforms last year, fearing the legislation would subordinate worker rights to capitalist interests. Moreover, labor and government are on a collision course over wages—frozen since March 1983—and productivity issues. Trimming public enterprises will be particularly difficult with urban unemployment already at 25 percent and 65,000 new positions needed annually to accommodate new, well-educated entrants to the labor force. [redacted]

The established patronage system will be difficult to overcome. Tunisia's economic experiments have had the effect of consolidating economic power in the hands of a narrowing spectrum of the population, especially in bourgeois groups who have obtained political influence and wealth through the ruling party and their positions in public enterprises. For example, the US Embassy says that managers of a stadium project in Bizerte were accused of embezzling $560,000 from the project. Swift intervention by the managers' patron resulted in their acquittal. This shift is visible in World Bank statistics, which show that the poorest 20 percent of the population accounted for 6 percent of total consumption in 1966 and 5 percent in 1980. In contrast the share of the richest 5 percent rose from 18 percent in 1966 to 22 percent in 1980. [redacted]

[redacted] 25X6
[redacted] Investor 25X6
confidence in Tunisia is eroding, and the leadership lacks the will to move forward with economic liberalization. Politicians—including the Prime Minister—are increasingly jockeying for position in the post-Bourguiba era while the President's [redacted] 25X6 faculties are less focused on economic policy. We expect that the government will defer major action on privatization until after the President passes from power. [redacted] 25X1

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Outlook

To please both investors looking for profits and entrenched officials with vested interests in the patronage system, the government has embarked on a system of reforms unlikely to please anyone. The poor economic prospects for the near term will, at a minimum, slow the government's ability to proceed with public enterprise reform. Nevertheless, the new laws provide a legal framework within which a successor government can begin true privatization. Prime Minister Mzali probably will continue Bourguiba's efforts to pull the government out of more segments of the economy if he can consolidate his position after the President leaves office. In the meantime, the government will continue to seek badly needed financial breathing room by cajoling other investors to assume a larger portion of the economic 25X1 burden. [redacted] 25X1

A number of options are available to the Tunisian Government that could accelerate the process of private involvement in the economy. The US Embassy in Tunis is promoting joint ventures and trade between US and Tunisian partners and provides local businessmen with information designed to improve their competitive position in world markets. Increasing the efficiency of the financial system as well as rationalizing agricultural production and distribution systems probably would have the greatest impact and meet with the least amount of opposition. Promotion of additional trade regulation and tax policy reform would help to rationalize the privatization effort and redress imbalances caused by privatization incentives. [redacted] 25X1

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Pakistan: Privatization in Question 25X1

We do not expect privatization in Pakistan to pick up much from its current slow pace. We believe that some of the country's new civilian leaders will be reluctant to antagonize the trade unions or forgo the patronage opportunities associated with economic controls and management of large-scale public enterprises. Although the new civilian government has promised to continue denationalization, the dismissal of its key proponent, Dr. Mahbubul Haq, from the Finance Ministry is a bad omen. Pakistan is likely to only partly divest some key industries. Foreign participation will be limited, given Pakistan's political history and tenuous location. The perennial money-losers will remain a burden on the government.

Back and Forth

Since independence in 1947, Pakistan's economic policies have vacillated between support for the private or public sectors. During the civilian and martial law administrations of the 1950s and 1960s, capital-intensive and large-scale private investment was promoted. These policies were reversed by the Bhutto administration (1971-77), which increased economic controls on the private sector and instituted a wide-ranging nationalization of Pakistani industry, banking, and insurance.

With the return to martial law in 1977, the Zia administration reduced government investment in public-sector industries, liberalized some imports, eased regulations impeding private investment, and attempted—with limited success—to privatize public-sector industries. In our view, Islamabad was successful with "easy" targets such as small-scale rice husking plants, cotton-ginning facilities, and flour mills that had few liabilities, required little new investment, and had been previously owned by private entrepreneurs. Privatization, however, soon stalled because many former owners refused to reclaim unprofitable operations, and the government was reluctant to provoke trade union opposition.

Measured Moves Toward Privatization

This year's budget—drafted by former Finance Minister Mahbubul Haq—outlined a renewed effort to liberalize Pakistan's control-laden economy. According to press reports, Islamabad promised to reduce onerous regulations and formulate plans to partly divest government-controlled banking, energy, transport, and manufacturing operations.

In our view, Pakistan's renewed interest in privatization stems more from budgetary and financial strains than from ideological commitment. Since FY 1978,[1] Pakistan's deficit has increased—in real terms—more than tenfold as a percentage of GDP, and a deteriorating foreign payments situation last summer caused reserves to fall to less than $325 million—equivalent to the value of about three weeks' imports—limiting funds available for imported equipment and raw materials. Prospects for increased concessional aid over the next few years are not bright, forcing Islamabad to take a hard look at money-losing public-sector firms and to consider selling stock in profitable firms to raise cash.

Public-sector firms play a key role in Pakistan's economy because they dominate energy, transport, banking and insurance, and large-scale industries—steel, cement, and chemicals. Some of these firms are losing money even with generous subsidies, cheap bank credit, and other transfer payments. In FY 1984 total pretax public-sector "profits" accounted for less than half of the subsidy on fertilizer production alone, according to official statistics. Even the well-managed public-sector entities, such as Pakistan International Airlines (PIA), are strapped for cash, according to Embassy and official reports.

[1] The Pakistani fiscal year begins on 1 July.

The civilian government, which came to power last December, proposed to partly divest public-sector enterprises ranging from the airlines and oil production to cement and government-run textile mills. The first offer of over $100 million in shares includes firms like PIA and the State Oil Corporation, which are being sold at 30 percent below market rates. The second offer, however, includes an unpalatable selection of 12 money-losing enterprises. Some of these firms are not even functioning—one has been closed for five years, according to Embassy reporting.

Economic and Political Impediments

Pakistani investors are being very cautious toward the divestiture program. Initial stock market reaction was negative, with public-sector stocks taking a beating, according to press reports. Public company stocks only recovered when local investors learned that most shares will be sold to expatriates. Some investors are concerned that partial divestiture—Islamabad is willing to sell a maximum of 49 percent of the shares—will still allow government control, increasing the potential for mismanagement and losses. Investors are also disturbed over unclear regulations that may force them to assume the liabilities of public-sector firms in which they purchase shares. In addition, Islamabad has indicated that new owners will not be able to reduce union-dominated and bloated work forces, according to US Embassy reporting.

Moreover, Pakistan's weak capital market may be unable to absorb the proposed divestiture. Although the government raised more than $1 billion—much of it borrowed from banks—from special bond schemes last year, these actions probably have drained much of the available private capital. One Pakistani analyst notes that the Karachi Stock Exchange, the country's largest, could raise only an estimated $24 million in its peak year of FY 1984.

An informal alliance of Pakistani bureaucrats, politicians, and trade union leaders is likely to impede progress on divestiture. The recent dismissal of Mahbubul Haq from the Finance Ministry suggests that his archrival Ghulam Ishaq Khan—a longtime opponent to privatization—is likely to play a more prominent role in economic policy making. We believe that some of the new civilian leaders will be reluctant to forgo the patronage opportunities associated with economic controls and management of large-scale public enterprises. In addition, we judge that the Junejo administration will be particularly sensitive to trade union demands to protect workers, adding another disincentive to increased private investment.

Prospects for Foreign Investment

Islamabad's efforts at divestiture will probably offer few opportunities for increased foreign investment. Islamabad is considering selling PIA shares on the New York Stock Exchange, but most shares in other companies are reserved for Pakistani expatriates or citizens, according to US Embassy reports. Although the government has publicly welcomed outside investment, direct foreign investment has always been small, averaging only $60 million a year since FY 1978.

Pakistan's history of political instability, its tenuous location, and foreign exchange problems make it unattractive to most foreign investors. Last year, international bankers raised commercial loan rates to Pakistan because of its shaky foreign exchange position. Foreign investors have often complained about the country's excessive bureaucratic delays and inadequate economic infrastructure which lower productivity, raise costs, and complicate business transactions, according to Embassy reports. Government policies also discriminate against foreign investment by restricting imports and increasing domestic content requirements.

Outlook

We expect bureaucratic, political, and economic constraints to slow the pace of privatization in Pakistan. With the removal of Mahbubul Haq, there will be little impetus to push economic change. The new civilian government is especially sensitive to domestic political concerns and is likely to back away from privatization if opposition arises.

Moreover, only a few well-managed and profitable firms are likely to attract investors. Islamabad still will have to subsidize the money-losers—the ones it

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needs to sell—because of lack of investor interest. Pakistan's weak capital market and uncertainty over government regulations on worker dismissals and assumption of liabilities are also likely to limit the extent of privatization.

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The Private Sector in Egypt: Clouded Horizon

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Despite rhetoric proclaiming Cairo's commitment to expansion of the private sector, progress in recent years has been slow. The growing economic crisis enveloping Egypt will probably jeopardize future private development efforts by forcing the regime to abandon its limited support for private initiatives and instead, concentrate on preserving domestic order. Moreover, we doubt that in an atmosphere of economic austerity and political instability private entrepreneurs would be willing to accept the heightened financial risks that accompany a larger role in the economy. Only a major shift in government and public perceptions would encourage greater privatization at this time. Given current social and economic trends in Egypt, the prospects for such a shift are poor.

The Private Sector in Egypt

The role and extent of the private sector in Egypt are significant. Since President Sadat broke with the Nasir policy of pervasive state control and proclaimed the "open door" policy in 1974, the private-sector's share in Egypt's industrial output has grown from just over 20 percent to one-third. The private sector generates over 60 percent of GDP when the agricultural and service sectors are added. In addition, the banking system, once dominated by four nationalized Egyptian banks, has become more competitive as dozens of private Egyptian banks, joint ventures, and foreign branches have been established.

Although the private sector has undergone important development, it is circumscribed by government controls. A prime example is the agricultural sector, which, although predominantly in private hands, is manipulated by the government through regulation of input and output prices. In the past few years, slow adjustments in producer prices combined with rapid increases in farm costs have not only discouraged production but also shifted it in favor of certain crops (for example, clover and corn) which the country should not be emphasizing. Producer prices for most major crops have been set at relatively low levels to provide low-cost inputs to domestic industry and inexpensive food to urban dwellers.

Procurement prices have been considerably revised during the past year, but state control over the pricing mechanism remains intact.[1] For most crops, procurement prices continue to be determined by the Ministry of Agriculture in conjunction with other ministries. In all cases decisions are reviewed by the Cabinet Higher Economic Policy Committee. The multiplicity of decisionmakers as well as the heavily politicized nature of the decisionmaking process ensure frequent delays in price adjustments and continued turmoil in the agricultural sector.

Nowhere is the stamp of government control more heavily felt nor the need for privatization greater than in the industrial sector. Fully two-thirds of industrial production originates from public-sector companies under the supervision of the Ministry of Industry and several other ministries. The nationalizations of the 1950s and 1960s brought most industries, including all heavy industry, under government ownership and management. Despite the adoption of the "open door" policies of the early 1970s, public-sector companies remain dominant in most industrial categories including textiles, food processing, engineering, and chemicals.

Public-sector companies involved in manufacturing have, in recent years, suffered from lagging productivity and sagging exports. The average compensation per worker, for example, was 12.8 percent higher in the first half of 1983-84 than in the first half of 1982-83, while the nominal value of output per worker increased by 10.6 percent during the same period. Despite wage boosts, government pay rates are low compared with wages offered in the private sector and abroad, with the result that it has become increasingly difficult for the public sector to retain skilled labor.

[1] The price the government pays to producers of cotton, rice, sugar cane, and wheat were increased by 20 to 30 percent during the fiscal year ending June 1985. Nevertheless, with the possible exception of wheat, prices paid to farmers are below international levels and provide little incentive to expand production.

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The relatively poor export performance of public-sector companies is largely attributable to inefficiency and the domestic orientation of these firms, tendencies that government policies do little to discourage. Trade barriers in the form of quotas in many industrial countries have also played a role, but poor quality control, noncompetitive pricing, and the priority assigned by the government to producing for the domestic market are the primary reasons for sluggish export growth. To a large extent, the industrial public sector has been used by the Egyptian Government to restrain the rate of inflation by limiting price increases for the numerous consumer goods this sector produces. In the process of contributing to domestic political order, the financial status of public-sector companies has been severely weakened, and, as a whole, they have become a net foreign exchange drain to the economy.

Recently, the Deputy Prime Minister suggested that the government is exploring the possibility of selling the public-sector shares of joint public-private ventures. Although this is unlikely to result in a substantial divestiture of government holdings, it is significant as the first indication of government willingness to consider privatization.

Recent Developments

Government policy proclamations urging new private initiatives suggest, at least superficially, that the climate for private-sector growth is excellent. Nonetheless, among many private business representatives there is a growing disquiet. The chronic foreign exchange shortage facing Egypt, in all likelihood, will continue to worsen, with an increasing disparity between free market and government-controlled rates. A strong possibility exists that the regime will attempt to tighten control of the private foreign exchange market to funnel more hard currency into government coffers. Such a policy was attempted in January 1985 with disastrous results for the private sector, which was starved for funds until the policy was revised four months later.

Although it would appear unlikely that Cairo would reintroduce policy initiatives so recently proved unsuccessful, the widening economic crisis may persuade the regime to adopt a variant of the 1985 program with equally negative consequences for the private sector. Moreover, even without new foreign exchange regulations, the growing shortage of hard currency will force government agencies to turn to the free market to obtain their foreign exchange requirements. This will drive free market rates ever higher and crowd out private-sector borrowers.

The government's commitment to the private sector is being questioned within business circles for other reasons as well. Policies currently in effect or proposed give many private investors the impression of bias in favor of the public sector. For example, except in cement/brick production where price equalization was recently accomplished, private foreign investors pay world market prices for energy but must compete with public-sector companies that acquire energy at heavily subsidized domestic prices. Moreover, in the current five-year plan—the primary development document of the government—public-sector investment remains programed at 77 percent of the economy's total. Finally, recently proposed changes in the tariff structure would raise rates on goods deemed nonessential by the government. The impact on private-sector imports is unclear, but many observers recall that, in the past, public-sector imports have received priority. It is the combination of these factors together with continued bureaucratic obstacles that send the wrong signal to investors and cast doubt on the government's sincerity about promoting the private sector.

Storm Clouds Ahead

As mixed as the outlook for private-sector initiatives has been, the immediate future appears even more grim. Egypt is entering a period of economic stress as a result of sharply declining oil prices, lagging growth caused by inappropriate economic policies, and increasing political discontent with the Mubarak regime. Major shifts in economic policy, whether self-initiated or formalized in an IMF-supported standby program, will be required to weather the growing crisis.

In this situation, where the population as a whole will be required to accept greater austerity, it will become more difficult to justify the perceived special benefits and privileges enjoyed by wealthy businessmen. Moreover, the strong social consensus in Egypt that holds the state responsible for the welfare of the population will, in a period of economic retrenchment, demand government solutions and government initiatives for the middle and lower classes. It will be politically unwise for the regime to pursue policies such as privatization that appear to contribute to the further enrichment of already wealthy entrepreneurs.

Businessmen themselves are unlikely to risk capital in an environment of economic and political uncertainty, particularly in the absence of strong new initiatives by the Mubarak regime to encourage private-sector development. There are few signs that the regime is preparing bold policy moves in this regard and abundant indications that the current drift in economic policy will worsen the climate for private-sector growth. The government has exhibited only a shallow commitment to private development, suggesting that much of its rhetoric, including proposals for privatization, is window dressing designed to beguile US interests.

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Syria: Trying To Tap the Private Sector 25X1

The Syrian economy is a socialist one, and it will remain so for the near term. The government owns all large industrial and extractive enterprises and controls most of the country's foreign trade. The poor state of the economy and a severe shortage of foreign exchange are forcing the government to undertake economic reforms and to seek ways of tapping the wealth and expertise of the private sector. This effort is being pushed primarily by one man, Minister of Economy and Foreign Trade Muhammad al-Imadi. Imadi appears to have the backing of President Assad for his efforts, but he faces serious opposition from entrenched leftist ideologues in the Ba'th Party, from a recalcitrant bureaucracy, and from public-sector managers who have vested interests in maintaining the status quo.

Privatization, in any real sense, is unlikely to occur in Syria under the present regime. Private investors may be allowed to have capital participation—up to 70 to 75 percent in some cases—in selected areas such as tourism and agriculture. This has already happened in some instances in tourist ventures. Arab and expatriate Syrian investors may also participate to a limited extent. It is unlikely, however, that Syria's dismal economic situation will force the government to privatize the large public enterprises to a meaningful degree or allow their control to slip from the government's hands.

The Road to Socialism

Before 1958, Syria had a long tradition of private enterprise and free market economic activity. The role of the state was limited to nonprofit services and infrastructure development. It owned and operated public utilities and transportation services including the railroads and airlines. When Syria joined Egypt in the United Arab Republic in 1958, the governing economic philosophy shifted toward socialism. Under President Nasir's decrees of July 1961, banks, insurance companies, and several industrial firms were nationalized. These measures were largely reversed following the breakup of the republic in September 1961.

This economic liberalization ended abruptly with the Ba'th military coup of March 1963. By the middle of 1965, the government controlled all banking and insurance companies, most of the industrial and transportation sectors, the energy sector, and over 75 percent of foreign trade. Although nationalization had largely ended by late 1965, the importance of the public sector continued to grow as most government investment was channeled into state-owned enterprises, as private capital fled, and as the private sector was hamstrung by government regulation.

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Currently, the government and the public sector employ about 43 percent of the labor force. Public-sector enterprises account for almost three-fourths of the output of the industrial sector and control almost 90 percent of import and export trade. They also produce about 70 percent of Syria's GDP. In 1983, public enterprises accounted for two-thirds of the fixed capital formation in the country. 25X1 25X1

The Private Sector in Syria

The private sector plays its most important economic role in agriculture, where most production is still in private hands. In the last 15 years there has been some de facto, though illegal, combination of plots into more economically viable units. Although production remains in private hands, the government plays a large part in the provision of agricultural inputs and the purchasing of agricultural output. 25X1

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Other areas of private-sector activity include real estate, tourism, textiles, food processing, and engineering. In general, private investors feel safe so long as their businesses are small enough not to attract government attention. There are no capital markets in Syria, and foreign exchange trading outside the banking system is illegal. 25X1

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Minister of Economy and Foreign Trade Muhammad al-Imadi

Minister Imadi, a 55-year-old Sunni Muslim, was born in Damascus. He was educated at Damascus University and New York University, receiving a doctoral degree in economics in 1960. He has held several economic positions in the Syrian Government, including that of Minister of Economy and Foreign Trade from 1972 to 1979. In April 1979 he accepted an appointment as head of the Kuwait-based Arab Fund for Economic and Social Development. Imadi returned to the position of Minister of Economy and Foreign Trade in July 1985 at President Assad's urging. He is described as a highly respected economist/technocrat known for his laissez faire philosophy and his pragmatic approach. He is well liked by the Syrian business community. [redacted]

Reform Moves

Syria's leading economic reformist, Minister Imadi, took office in July 1985 and, according to the US Embassy, quickly initiated studies on:

- Stimulating investment and production by subjecting public-sector companies to greater competition.
- Encouraging private investment in a broader range of mixed public-private ventures and even in purely private enterprises.
- Reform of the highly artificial exchange rate for the Syrian pound.
- Reduction of the large—up to 110 percent—deposit required for foreign exchange letters of credit to pay for imports. [redacted]

Imadi to date has helped implement several reforms, including a cut in the government subsidy of certain commodities by raising prices of fuels from 25 to 75 percent and by raising prices of sugar, tea, and cigarettes by 33 to 100 percent. At the same time, the government increased—by lesser amounts—civil servant wages and retiree benefits and increased fuel allowances for government employees. [redacted]

The government has also reduced the deposit required of private firms for imports of capital goods from 110 percent of their value to 50 percent. Decrees liberalizing private-sector imports of raw materials, spare parts, and agricultural commodities have been issued. Exporters and returning Syrian emigrants may now set up special foreign exchange accounts that can be used, with certain restrictions, to pay for imports. Lastly, the highly overvalued Syrian pound has been devalued for a few types of transactions. [redacted] 25X1

In its biggest move to date, [redacted] 25X1
[redacted] the Syrian Government has 25X1
circulated a proposed four-year economic reform that substantially expands the role of the private sector in the economy. The plan, approved by President Assad and the Cabinet, calls for:

- The duty-free import of all goods by the private sector.
- Private-sector manufacturing in any sector of the economy.
- Private-sector investment in and joint business deals with public-sector companies. 25X1
- Private-sector import of foreign currency without restrictions.
- The encouragement of Arab and expatriate Syrian investment in Syria.
- Central bank guarantees of foreign investment in the private sector. [redacted] 25X1

So far, foreign investment and joint private-public ventures have mainly occurred in agriculture and the tourist industry, where some hotels have been built. If the reforms take hold and investors can be found, new projects will probably involve 25-percent government ownership, with not more than 25 percent owned by foreigners. [redacted] 25X1

Outlook 25X1

Syria has tried several times in the last two decades to attract foreign investment with little success. It is unlikely to succeed to any extent in the future unless significant reform of the Syrian economy is implemented. Imadi also faces serious opposition to economic reform in general and may not be able to push his initiatives far enough to make a difference. The severe crackdown on illegal moneychangers and smuggling, which occurred in late January, can be seen as a setback to Imadi's efforts. This move would 25X1 seem to have gone against his philosophy and may have been, in part, an effort by Prime Minister Kasm and other ideologues to discredit Imadi and economic liberalism in general. [redacted] 25X1

Kasm and other Ba'thist leaders believe socialism is one of the cornerstones of the party's ideology, along with pan-Arabism. The party leadership believes the private sector, especially the merchant communities of Damascus and Aleppo, are reluctant Ba'thists at best. The Ba'th's junior partners in the ruling National Progressive Front, especially the Syrian Communist Party, are also traditionally suspicious of the private sector and likely to strongly resist privatization. [redacted] 25X1

Minister Imadi's initiatives face an uphill battle. President Assad, who generally has only a passing interest in economics, is being pressed by the poor state of the Syrian economy to make changes. In addition to Ba'thist opposition, economic reform along Imadi's lines and reform in general will face opposition from a recalcitrant bureaucracy and entrenched public-sector managers. Real privatization of Syria's public enterprises probably will not occur, nor will the economy be turned over to the free market to any significant extent. [redacted] 25X1

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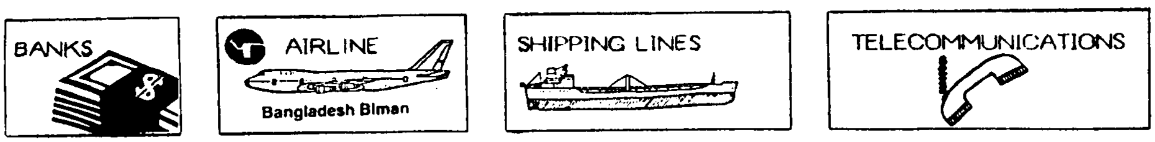
Near East and South Asia Briefs

Bangladesh **Creeping Privatization** 25X1

BANGLADESHI ENTERPRISES CONSIDERED FOR PARTIAL PRIVATIZATION*



*Government may sell up to 49% equity stakes to private investors. 25X1

Bangladesh's new five-year plan continues to put great emphasis on privatization and has earmarked one-third—$4.5 billion—of its budget to private-sector investment, according to press reports. The government sees privatization as a means to reduce budgetary pressures, improve efficiency, and attract "black money" now in private hands into the economy. The policy shift favoring privatization began after the imposition of martial law in 1975 and was reflected in Bangladesh's new industrial policy—providing incentives to the private sector and opening up most sectors to domestic and foreign investment.

Bangladesh's privatization program has found its way into many of the key sectors of the economy. Large parts of the jute and textile industry have been returned to the private sector—often to the individuals who owned them before nationalization. Planning for the partial divestiture of the shipping lines, national airline, telephone industry, and three of the four government-owned banks has begun. Press reports indicate that manufacturing and engineering enterprises are likely to be added to the list. Permission has also been granted for the establishment of private insurance agencies. Despite these efforts, the private sector lacks the funds and management expertise to take over many of the larger state enterprises, and foreign firms are not allowed to take over the entire equity, limiting their incentive.

President Ershad, although committed to privatization, may have to take a stronger hand to move the process along. The most useful steps would be to allow sponsors and investors in the private sector to assume a more active role in the management of firms and to have reforms in prices and tariffs accompany divestiture. Further progress will also depend on the cooperation of the trade unions and public-sector managers who see their livelihoods threatened by privatization. 25X1

Jordan

First Steps to Privatization [redacted] 25X1

A slowdown in Jordanian economic growth to 2 percent per year for the last three years has prompted Amman to reassess its economic strategy. A new Prime Minister was appointed in April 1985, in part to stimulate the economy. Financial limitations, however, have forced Amman to lower its goals for government stimulus of the economy and to move toward greater involvement of the private sector. We believe the overall prospects for privatization are dim, largely because Jordanian investors tend to avoid domestic projects in favor of more attractive foreign ventures. [redacted] 25X1

The Telecommunications Corporation was converted in March 1986 into a public shareholding company, paving the way for the government to begin selling shares in the corporation, up to now a government monopoly. The company has 130,000 telephone and 2,500 telex subscribers, numbers that probably will increase rapidly in the next few years. An extensive modernization program and expansion of networks is also under way. [redacted] 25X1

Similarly, a privatization plan for ALIA—Jordan's international airline—was approved in principle in December 1985 in order to modernize and expand the fleet. If the plan is carried out, 10 percent of ALIA's shares will be offered for sale. Subsequent offerings will depend upon how well the first offering is received. ALIA balance sheets, however, do not suggest there will be wide acceptance of the share offering. Losses totaled about $26 million in 1984, and the firm only broke even in 1985. [redacted] 25X1

Telecommunications and Airlines

Frequent Candidates for Privatization [redacted] 25X1

Telecommunications and airlines are among the industries that are most frequently considered for privatization by Middle Eastern and South Asian countries. [redacted] 25X1

Many telecommunications networks in the region are decades old and outmoded. At the same time, telecommunications needs have grown so rapidly and in so many new directions and technology of the industry has changed so much that monolithic organizations can no longer keep pace. Private enterprises have proved more adaptable than public ones in providing highly specialized equipment. Some countries of the Middle East and South Asia have joined industrialized Western nations such as the United States, the United Kingdom, and Japan to diversify and/or privatize their telecommunications industries. [redacted] 25X1

At least three countries in the region—Pakistan, Jordan, and Saudi Arabia—are privatizing their airlines as part of an effort to modernize them. We believe these efforts will be less successful than privatization of telecommunications. With the airlines, governments see privatization as a way to raise money for new equipment that the governments themselves cannot afford. Local financial markets, however, often cannot raise sufficient capital, and the airlines are often money-losers or are only marginally profitable and not attractive to investors. [redacted] 25X1

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